

Internal Audit Report 17-03
Accounts Payable
September 2017



City of Sioux Falls
Internal Audit Department
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ACCOUNTS PAYABLE INTERNAL AUDIT REPORT 17-03

INTRODUCTION

The Accounts Payable Audit was included on the 2017 Annual Audit Plan as a carryforward audit from 2016. The purpose of the audit was to review the accounts payable system and current procedures to ensure internal controls are in place and functioning. It should be noted that controls are intended to provide reasonable assurance, but cannot guarantee, that fraud and errors will not occur. The audit focuses on vendor management, invoice handling, and the accounts payable reconciliation process. This audit will not include a review of the purchasing process and will also exclude purchases made using a City credit card¹ as these areas are addressed in separate audits.

BACKGROUND

The City's accounts payable process is centralized within the Accounting Division of the Finance Department. The Accounts Payable (AP) staff are responsible for the receipt and processing of invoices for payment, assisting in the resolution of vendor issues, check printing, and providing support to all City departments. They are also tasked with effectively managing and monitoring the recording of all expenditures within the City and providing assurance that all payments made by the City are financially accurate. The Finance Department has 4 FTE's (full-time equivalents) dedicated to the centralized payment function. The table below shows the activity carried out by the AP staff.

Fiscal Year	# of Invoices Processed	Dollar Amount of Invoices Processed
2014	27,415	\$174,500,008
2015	27,890	\$175,643,992
2016	28,954	\$185,167,041
2017 (Jan. to July 2017)	13,454	\$ 93,105,582

Achievement of accurate and timely payments to vendors is the primary goal of the AP staff. However, to achieve this goal, they must collaborate with other departments in the City. The City uses the MUNIS software product to manage its financials. Department staff procure goods and services by creating an electronic requisition in MUNIS. The requisition is converted to a

¹ Any non-equipment or other purchase under \$1,000 is generally made using City credit cards, also known as purchase cards or p-cards, held by the various department heads.

purchase order by a specialist in the Purchasing Division of the Finance Department and then sent to the vendor. The duties of vendor set-up and Master Vendor File maintenance reside with designated AP staff. All vendors are required to register with the City, preferably through the online MUNIS Vendor Self Service (VSS) portal. A W-9 must be submitted by the vendor before business can be conducted with them.

When an invoice for the goods or services is received, it is scanned into MUNIS, compared to the purchase order, and entered into the system. Some invoices, such as those for refunds, utility payments, and contractual agreements, will not have a purchase order. The majority of invoices are either mailed to the AP office or submitted electronically via email to the Finance AP inbox. Prior to payment, all invoices must be reviewed and approved by the department manager or Finance. Once approved, an AP clerk can process the invoice which posts the debit to the corresponding expense account. Invoices approved and processed will advance to the weekly check run process or EFT (electronic funds transfer) payment process. Prior to the release of checks and EFT payments, an Accounts Payable Warrant report is sent to the Finance Director and Mayor for signature approval.

Summary of Checks and EFT Payments

Fiscal Year	# of Disbursements		% of Total Dollar Value	
	Checks	EFT Pmts.	Checks	EFT Pmts.
2014	6,579	6,147	19%	81%
2015	6,450	6,753	16%	84%
2016	6,345	6,980	18%	82%
2017 (Jan. to July 2017)	3,252	3,275	16%	84%

OBJECTIVES

The objectives of this audit were to:

1. Determine if adequate controls exist over the process of vendor setup, maintenance, and validation.
2. Determine if adequate controls are in place to ensure payments are mathematically accurate, properly supported, authorized, and remitted in a timely manner.
3. Determine if adequate controls are in place to prevent duplicate payments to vendors.
4. Determine if an accurate and timely reconciliation is prepared between the accounts payable bank account and general ledger.

SCOPE AND METHODOLOGY

The scope of this audit included a review of the current vendor listing, system access, and policies and procedures. The detailed testing of transactions covered the 12 month period of June 1, 2016 to May 31, 2017. Our audit work included the following:

- Interviews with accounts payable management and staff.
- Review of prior audit recommendations.
- Research of best practices in vendor management and accounts payable.
- Review of written policies and procedures over vendor management and accounts payable.
- Review of Master Vendor File for duplicate vendors and proper maintenance.
- Review of system access to the Master Vendor File.
- Analytical review of the Vendor Payment History report dating back to January 1, 2014.
- Review of a sample of vendor files.
- Detail testing of a sample of randomly selected invoices processed using a confidence level of 95% and a sampling error of plus or minus 3%.
- Review of invoices greater than \$500 for the period being tested for duplicate payments.
- Review of a judgmentally selected sample of monthly reconciliations.

RESULTS

Vendor Management

We interviewed management, reviewed internal policies, reviewed and analyzed the Master Vendor File and Vendor Payment History, and reviewed a random sample of 42 vendor files. We determined that the following internal controls exist over the process of vendor setup, maintenance, and validation.

- AP staff perform an independent review of the vendor information entered in VSS to ensure it is accurate prior to activation.
- A W-9 is required to be on file prior to conducting business with the vendor.
- AP staff verify the taxpayer identification number (TIN) provided by the vendor to the Internal Revenue Service TIN matching program provided online.
- An ACH form for bank to bank payments is required to be on file in order to conduct EFT payments.
- AP staff review a random selection of vendors being paid to verify name of company, banking information, federal tax ID, and address to which the remittance will be sent.
- Changes made to the Master Vendor File are reviewed on a monthly basis by management.

The following audit findings were noted during the review and testing of the vendor management process. Recommendations are included on page six to address these issues.

Audit Finding 1:

Based on review of the Master Vendor File, we determined there are (1) duplicate vendors, (2) vendors with identical addresses, (3) vendors with no activity during the last 3 years, and (4) vendor names that are not in agreement with the Master Vendor File Naming Convention Policy. We also determined the Master Vendor File has not been thoroughly reviewed since the implementation of MUNIS in 2014. Best practices encourage keeping the vendor file free from inactive vendors and erroneous data by regularly reviewing the file on at least an annual basis. A “clean” vendor file will decrease the opportunity for remittance errors and fraudulent vendor practices and will increase user efficiency. **See recommendation 1 below.**

Audit Finding 2:

We reviewed access rights to the Master Vendor File and to the various roles within MUNIS and determined the following:

- nine employees within the Finance Department currently have access to create a new vendor, enter invoices, and print checks, and
- fifteen employees within the Finance Department currently have access to enter invoices and print checks.

Even though there are mitigating controls, unnecessary access to the above activities creates an opportunity for fraud and/or misappropriation of assets. **See recommendation 2 below.**

Invoice Handling

We selected and obtained a random sample of 42 invoices. We recalculated the payment amount on the invoice to ensure it was mathematically accurate and verified that the amount paid agreed with the check stub or EFT payment notification. We verified that proper approvals were obtained prior to disbursement by reviewing the workflow approval status in MUNIS, the purchase order information, contract agreement information, etc. We also verified that payment was timely by comparing the invoice date, the date stamp on the invoice, and the check or EFT payment date. Based on the testing, we conclude that adequate controls are in place to ensure payments are mathematically accurate, properly supported, authorized, and remitted in a timely manner.

Duplicate Payments

We obtained a listing of all invoices paid during the testing period. We sorted the list of invoices and identified identical invoice numbers with identical amounts for the same vendors. We then reviewed each invoice greater than \$500. We did not identify any duplicate payments which provides assurance that proper internal controls are in place to prevent duplicate payments to vendors.

AP Reconciliations

We judgmentally selected a sample of two monthly reconciliations between the accounts payable bank account and general ledger. We determined that the reconciliations are materially accurate and properly completed each month. Each monthly reconciliation is sent to management for review and sign-off.

RECOMMENDATIONS

We made the following recommendations to address the above referenced audit findings.

- 1) We recommend that management ensure the Accounts Payable Policy and Master Vendor File Naming Convention Policy are consistently followed. The AP policy states that the Master Vendor File will be reviewed on an annual basis and all vendors not used within the last three years will be inactivated. The policy also states that the process by which vendor names are entered in the Master Vendor File will be standardized. Vendors with no payment activity for a specified period of time should be inactivated. In addition, duplicate vendor records should be corrected and the accuracy of vendor information should be verified.

Management's Response: We will complete a cleanup of the master vendor file, including duplicate vendors, standardization of naming, and inactivation of vendors with no activity in the last 3 years prior to year-end. We will continue to perform this process in December of each year going forward. Staff will continue to reference the Master Vendor File Naming Convention Policy for the addition of all new vendors.

Management Representative Responding: Janelle Zerr, Finance Manager

Date of expected implementation: December 31, 2017

- 2) We recommend that management ensure proper segregation of duties exists by requesting that those with unnecessary access to various accounts payable activities in MUNIS are deactivated.

Management's Response: We agree that it would be preferable to have fewer users with access to multiple roles. However, software limitations and efficient operations require certain individuals to have multiple role access. To compensate, we have implemented review controls to mitigate any risk of loss, including a separate review of changes to the vendor file on a monthly basis by an independent manager. In addition, we will be adding an independent monthly review of all Finance employee role changes.

Management Representative Responding: Janelle Zerr, Finance Manager

Date of expected implementation: December 31, 2017

OPPORTUNITY FOR IMPROVEMENT

The following recommendation does not address an audit finding, but rather an opportunity for improvement to the accounts payable process.

We recommend that management establish, document, and implement a standardized invoice coding process for all invoices entered for payment. The AP staff often receive invoices that do not have invoice numbers and, therefore, they assign a random number/name to the invoice. If the invoice is entered a second time and formatted different from the original entry, the system would allow payment of both invoices. The Accounts Payable Policy states that invoices will be standardized when entering them into MUNIS. It does appear that AP staff have attempted to enter invoices in a consistent manner. However, with no formal written policy to outline the formatting rules, it makes it difficult to remain consistent and the risk of an invoice being paid twice increases. With the implementation of a standardized invoice coding policy, the risk for duplicate payments will decrease. It will also increase the efficiency for Finance staff when researching financial records to determine if an invoice has already been paid.

CONCLUSION

Overall, adequate controls exist over the accounts payable process administered by the City's Finance Department. We noticed that, with the implementation of MUNIS, additional controls are now in place since the prior audit in 2008. The AP staff are processing payables on a timely basis. Based upon our audit design and tests, we did not identify duplicate payments or unusual activity and we do not have reason to believe fraud exists. The recommendations above, which are based on industry best practices, will provide additional assurances through increased risk mitigation designed to prevent errors and fraud. We would like to thank the Finance Department staff for their cooperation and assistance provided during the audit.

AUTHORIZATION

The Sioux Falls City Council approved this audit by resolution in April 2017 as a carryforward audit from the 2016 Annual Audit Plan. The Internal Audit Division operates under the authority of an Internal Audit Charter adopted by City Council resolution 11-13.

AUDIT STANDARDS

This audit was conducted in accordance with the International Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors.

STATEMENT OF INDEPENDENCE

Internal Audit is administratively and operationally independent of the programs and departments it audits, both in appearance and in fact. The Internal Audit Manager is accountable to an Audit Committee appointed by the City Council per section 32.022 of the Code of Ordinances of Sioux Falls, SD.

DISTRIBUTION OF REPORT

This report is intended for the information and use of the Mayor and City Council, management, and others within the City of Sioux Falls. However, the report is a matter of public record and its distribution is not limited.

PERFORMED BY

Ashley VanDeBerg
Internal Auditor